105th Congress, 1st Session: No. 18 July 14, 1997

INFORMED BUDGETEER

IF IT SOUNDS TOO GOOD, THERE IS A CATCH

- The Finance Committee-reported Revenue Reconciliation Act of 1997 contains provisions transferring the current 4.3 cents gas tax revenues used for deficit reduction to the Transportation Trust Funds. Proponents proclaim these revenues should be deposited into the trust funds and used for transportation purposes only.

- While this sounds good, the consequences of this action are more painful than proponents would have you believe. The effort to transfer this revenue will put additional strain on the discretionary caps established under the Bipartisan Budget Agreement. There would be increased pressure to spend an additional $36.2 billion for transportation purposes above the already agreed to increases in transportation spending in the Agreement.

- While most Senators support the increased transportation spending already contained in the budget agreement, the result of transferring the 4.3 cents would require all other non-transportation spending including education, environment, crime, and health programs to be reduced by $36.2 billion over the next five years to accommodate additional transportation spending above the Budget Agreement.

- The *Bulletin* has looked at total non-defense discretionary spending and allocated this $36.2 billion reduction over the next five years by Appropriations subcommittee. The largest reduction is to the Labor/HHS subcommittee, with a five-year total reduction of $12.3 billion.

- The Bulletin's advice: if something is labeled "truth in budgeting" or "putting the trust back into trust funds" there ultimately has to be a catch. Because of discretionary caps on total spending in the Agreement no program increases are totally free of pain while reaching a balanced budget by 2002. Spending more in one area, even from a "trust fund" account, will result in decreases in other areas of discretionary spending.

Reductions Needed to Stay Within Discretionary Caps
(BA-$ in Billions, by subcommittee)

Subcommittee	5-year reductions
Agriculture	2.1
Commerce, Justice, State	4.7
District of Columbia	0.1
Energy & Water	1.4
Foreign Operations	2.0
Interior	2.0
Labor- HHS	12.3
Legislative Branch	0.4
Transportation	--
Treasury	2.0
Veteran's Affairs- HUD	9.3
TOTAL	36.2

SENATE PASSED MEDICARE & MEDICAID

- CBO estimates of the Senate passed spending reconciliation bill indicates that the Senate exceeded the targets established for the Bipartisan Budget Agreement for Medicare but fell for short for Medicaid and Children's Health

- For Medicare, the Senate bill would save $117.6 billion over five years and $446.6 billion over ten years. ($1.5 billion in low income assistance is counted in the Medicaid savings estimate.)

- In Medicaid and Children's health, CBO's original tables had an error in the outyears which understated savings in Medicaid. In the corrected estimates, Medicaid's savings are $10.3 billion over five years and $42.8 billion over ten-- $3.3 billion over five years and $22.8 billion over ten short of the BBA target.

- In children's health, including the spending and tax bills, CBO estimates costs of $26.5 billion over five years and $49.8 billion over ten. This is above the Agreement levels of $16 billion over five years and $38.9 billion over ten years.

Medicare: Senate Passed Reconciliation
(CBO Estimates- $ in Billions)

	2002	98-02	98-07
Medicare Choice	-14.4	-26.5	-150.7
New Spending:			
Medigap portability	0.1	0.5	1.5
Demonstrations	0.0	0.5	0.5
Prevention benefits	0.7	3.7	7.3
Outpatient coinsur. buy-down	1.2	2.2	18.1
Rural initiatives	0.4	1.5	3.9
Subtotal, New Spending	2.4	8.4	31.3
Provider Payments:			
PPS hospital update	-4.4	-14.5	-39.6
PPS exempt hospital update	-0.9	-3.0	-8.5
DSH payments	-0.9	-2.4	-2.5
Capital	-1.0	-4.8	-10.5
Indirect medical educat. (net)	0.4	0.7	5.3
Direct medical education	-0.2	-0.7	-2.7
Eliminate add-on for outliers	-0.4	-2.1	-4.8
Treatment of transfer cases	-0.2	-1.1	-2.3
Physician payments	-1.6	-5.	-11.7
Outpatient PPS	-2.2	-9.4	-21.3
Skilled nursing facilities	-2.8	-8.2	-27.9
Home health payments	-4.6	-15.6	-48.2
Other	-1.5	-5.1	-16.8
Subtotal, Provider Payments	-20.3	-71.5	-191.5
25% part B premium	-5.8	-12.4	-78.1
Income related part B premium	-1.6	-3.9	-19.6
Home health copayment	-1.0	-4.7	-10.5
Conform retirement age to SS	0.0	0.0	-10.2
Medicare secondary payer	-2.1	-7.9	-20.1
Other	0.5	0.9	3.4
TOTAL, MEDICARE	**-42.3**	**-117.6**	**-446.0**
Bipartisan Budget Agreement	-40.0	-115.0	-434.0

Medicaid & Children's Health: Senate Passed Reconciliation
(CBO Estimates- $ in Billions)

	2002	98-02	98-07
Medicaid:			
Disproportionate Share Hospitals	-4.5	-12.3	-44.2
Repeal Boren Amendment	-0.5	-1.2	-6.9
Allow mcaid rates-QMB & duals	-0.5	-2.1	-5.3
Increase match rate for DC	0.0	0.3	0.3
Increase match rate for Alaska	0.0	0.2	0.2
Puerto Rico & other territories	0.0	0.1	0.4
Women w/cancer-opt .coverage	0.0	0.1	0.4
Waive certain provider tax prov.	0.0	0.2	0.2
Continue state-wide 1115 waiver	0.2	0.8	1.5
Veterans pension treatment	0.0	-0.1	-0.2
Prudent lay-person standard	0.0	0.1	0.2
Assure adequate mngd care pmts	0.0	0.2	0.4
State grants for premium assist.	0.3	1.5	1.5
Medicare interaction	0.7	1.9	8.7
Subtotal, Medicaid	-4.3	-10.3	-42.8
Children's Health:			
Children's health[A]	5.5	23.6	46.5
Medicaid impact: OBRA 90 kids	0.0	0.4	0.4
Medicaid: Outreach	0.6	2.6	2.6
Medicaid: 12 mo. cont. eligibility	0.0	0.1	0.3
Subtotal, Children's Health	6.1	26.7	49.8
Total, Medicaid & child health	**1.8**	**16.4**	**7.0**
Bipartisan Budget Agreement:			
Medicaid	-6.2	-13.6	-65.4
Children's Health	3.9	16.0	38.9
Total	2.3	2.4	-26.5

[A]Includes Spending & Tax Bills.

COMPETING CHILD CREDITS

- During the July 4th Congressional recess, the President announced a new version of his child credit. The Administration now advocates a child credit of $400 in 1998, $500 in 1999 and indexed thereafter. It would be available to children under age 17 through 2002 and under age 19 thereafter. It would begin to phase out at $60,000 joint income until 2000, and begin to phase out at $80,000 joint income thereafter. Besides the very low income cutoff points, *two very important features distinguish the President's credit from the Senate or House child credit.*

- 1) The President's child credit is figured before eligibility for the EIC is taken into account; and, 2) The President's child credit is refundable to the extent that the employee's share of payroll taxes exceeds the taxpayer's earned income credit (EIC).

- The table below shows that in 1999 for a 2-parent family with 2 kids, the payroll tax burden is no longer fully offset by the current law EIC at about $22,000 of income. However, families still receive the refundable portion of the EIC (they owe no income tax and receive a check from the Treasury) until they reach $26,000 of income.

- The President's child credit, because of the way he "stacks" it before the EIC, begins to kick in at $19,000 of income, far before a 2-parent family with 2 children would realize any net payroll tax burden *under current law*. Furthermore, because the President has a refundability feature to the extent payroll tax exceeds EIC, the $70 billion cost of the President's child credit is about 90 percent tax cut, 10 percent outlay increase.

- The Senate child credit, which is computed by excluding ½ of EIC currently received, kicks in at $24,000 of income, about $2,000 above the income level where this family would have a net payroll tax burden.

- The EIC was designed to offset the burden of payroll taxes at the very lowest income levels. The EIC has been greatly expanded over time to offset payroll as well as income taxes for a family of four up to a $22,000 income level. Yes, at some point people will realize a net payroll tax burden, but the social security system was designed this way. Keep in mind that the combined social security tax and transfer payment system substantially favors low and middle income taxpayers compared to higher income taxpayers. Analyses that focus on the burden of payroll taxes without acknowledging the benefits vastly overstate the burden.

Effects of Child Credit Proposals
2 parent family with 2 kids-1999

	Current Law		Amount of Child Credit		
Earnings	Income Tax[A]	Payroll Tax	House	Senate	President
$15,000	-3,369	1,148	0	0	0
$17,000	-2,948	1,301	0	0	0
$19,000	-2,451	1,454	0	0	75
$20,000	-2,091	1,530	0	0	225
$21,000	-1,730	1,607	0	0	375
$22,000	-1,370	1,683	0	0	525
$23,000	-1,009	1,760	0	0	750
$24,000	-648	1,836	0	88	1,000
$25,000	-288	1,913	0	344	1,000
$26,000	73	1,989	73	599	1,000
$27,000	433	2,066	433	854	1,000
$28,000	794	2,142	794	1,000	1,000
$29,000	1,155	2,219	1,000	1,000	1,000
$30,000	1,515	2,295	1,000	1,000	1,000
$31,000	1,875	2,372	1,000	1,000	1,000

[A]after EIC; SOURCE: Congressional Budget Office. Italic is income range where the payroll tax burden is no longer fully offset by the EIC.

IS IT FOR BETTER OR FOR WORSE?

- CBO released a new study titled, "For Better or Worse: Marriage and the Federal Income Tax." The study examines the "marriage penalty," where married couples pay more in taxes than they would if they were single, and the "marriage bonus," where married couples pay lower taxes than they would as single filers.

- Couples who incur the highest marriage penalty are two-earner couples in which the couple has roughly equal incomes. Couples lucky enough to see a marriage bonus have just one wage earner or the husband and wife have quite different incomes.

- It is not surprising that demographic changes since the 1960s, such as more two earner families and greater equality of income between husbands and wives, have caused an increase in the share of couples incurring a marriage penalty.

- CBO estimated that 42 percent of couples incurred a marriage penalty in 1996, while 51 percent received bonuses. These percentages vary with income levels: for couples with AGI under $20,000, only 12 percent saw a marriage penalty while 63 percent realized a bonus. For couples with AGI above $50,000, 54 percent realized a penalty while 44 percent saw a bonus.

- CBO also simulated the marriage penalty under 1996 tax law using 1969 demographic characteristics. CBO found that without the demographic changes over the past twenty-five years, less than one-third of couples would incur a marriage penalty (vs. 42 percent) and two-thirds would get bonuses (vs. 51 percent).
- The CBO study evaluates different approaches to reduce the marriage penalty, such as raising the standard deduction for joint filers, exempting from taxes some income of the lower earning spouse, modifications to the EIC, allowing couples to choose filing status. *Bulletin's* favorite: fundamental radical tax reform.

ECONOMICS

EUROPE STRUGGLES TO MEET DEFICIT TARGETS

- European countries are currently in the throes of trying to meet the strict entry requirements for European Monetary Union (EMU). Amongst other criterion, countries would only be eligible to join if their fiscal deficit/GDP ratio was below 3 percent by 1997. Final judgement on eligibility is to be made in May 1998 at the meeting of European Union leaders.

- However, given the possibility that both Germany and France may miss this deficit target slightly, some entrance flexibility is expected. Only Luxembourg currently meets all the EMU entry requirements. (Of note, the US would have no trouble with the fiscal deficit target, with its 1997 deficit expected under 1 percent of GDP).

- The greater concern for EMU is likely to come after its formation. It will be very difficult for its members to maintain a low fiscal deficit into the next century without substantial reform of their social welfare programs. Social security programs are already a drag on some European fiscal coffers, even before the babyboomers retire. In fact, Italy would be in budget surplus now but for its social security transactions.

- Concerns over Europe's fiscal situation appear to be diverting some portfolio flows from Europe into the US. Although first quarter US current account figures show a drop off in overall foreign private investment into the US relative to the previous quarter, there was a noted rise in private European purchases of US equities and continued strong European buying of US Treasuries. These flows seem to support anecdotal reports by market participants of increased European interest in US assets given their safe-haven status.

- This is also consistent with the recent surge in the share of foreign holdings of public Treasuries -- this ratio climbed to 35 percent at the end of March, up from 28 percent at the start of 1996. (Both are considerably above 1992's ratio of 19 percent).

✎**EDITOR'S NOTE:** The *Bulletin* apologizes for any confusion caused by two items in last week's edition. First: In regards to the ten year tax cut in the Senate bill, the *Bulletin* meant the impact on the deficit over the next ten years was $254 billion -- net tax cuts of $244, plus $2.3 billion for Amtrak and $8.0 billion for child health. Second: the $53.4 billion estimate for additional spending over ten years for Children's Health has since been revised by CBO and new estimates, in the table above are correct.